

Pension Plans



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Employee Pension Plans

In the previous issue, we dealt with the OAS and CPP. In the current issue, we will provide you with general information of the third level of Canada's Retirement Income System being private and RRSP's. We encourage you to send copies of this news release to your employees.

The third level: Private Pension Plans

It is important to know where your other income could come from in retirement. This brings us to the third level of Canada's retirement income system: private pensions and savings. It's up to you to determine how much you'll need in retirement and to plan for it! The system of Registered Pension Plans and Registered Retirement Savings Plans is the primary way that the Government of Canada assists you in saving for retirement. The savings in these plans are tax-assisted - contributions are tax deductible and investment income is not taxed as it is earned. The tax is paid when funds are withdrawn from these plans or received as pension income. You may also have other personal savings that will grow and supplement your income.

Employer pension plans

About 40 percent of workers in Canada are covered by an employer pension plan. Formally called Registered Pension Plans (RPPs), these plans are registered with Canada Revenue Agency and the appropriate federal or provincial regulatory authorities. Once an employer sets up a plan, it must comply with tax and pension standards rules. If you are in a contributory plan, your employer deducts from your pay cheque any contributions you are required to pay, and reports the total on your T4 tax slip each year. Your annual contribution is tax-deductible. There are two principal types of employer pension plans - defined benefit plans and defined contribution plans. The type of plan you belong to is important, because it affects the pension you will receive when you retire. In a defined benefit plan, you're promised a monthly pension income that is determined (or "defined") by a formula, such as a combination of your earnings, job classification and the length of time you worked for the employer. It is generally the employer's responsibility to ensure that sufficient funds are available to pay your pension when you retire. The employer assumes the risk of investing all contributions wisely to guarantee the future value of your pension.

In a defined contribution plan (or money purchase plan), the amount of the pension you receive is not set in advance. Instead, you and your employer contribute a set (or "defined") amount to the plan, usually determined as a percentage of earnings. An account is set

up in your name and the contributions are invested by your employer. Some plans give you a choice of how you want the contributions invested. Your pension will be based on the funds that have accumulated in your account when you retire.

How much income to expect

Depends on normal retirement age

Most pension plans specify a "normal" retirement age. This is the age when you can retire with a full pension, typically 65. Under many plans, the normal retirement age is based on your years of service with the company or a combination of your age and years of service.

You may be entitled to take early retirement up to ten years or more before normal retirement age. If so, your pension will normally be reduced because you will be receiving it for more years. Some plans allow you to postpone your retirement as late as the end of the year in which you turn 69, which may result in an increased pension to reflect the fact that you did not start receiving it at 65.

Defined benefit pension amount depends on your plan's benefit formula

With a defined benefit pension plan, the benefit amount is usually calculated based on your plan's benefit rate, your years of service and a measure of your earnings. The formula your plan uses is described in your pension plan booklet. For example, you may receive a pension of up to two percent of your earnings for each year of service.

This percentage is important because it determines the amount of your pension. Under the tax rules, defined benefit plans may provide a pension benefit of up to two percent of earnings per year of service (up to a maximum amount).

Some pension plans are integrated with Canada Pension Plan (CPP) or Quebec Pension Plan (QPP)

Defined benefit pensions sometimes take into account the pension you receive from CPP/QPP. If so, it's called an "integrated" plan because the promised level of benefits is provided in combination with the CPP/QPP. If you retire early, the pension your plan provides will likely be reduced once you are 65 and are receiving CPP/QPP benefits. It's a good idea to find out now if your pension plan is integrated and how this will affect your monthly pension income throughout your retirement.

Defined contribution pension amount depends on how much has been saved

In a defined contribution pension plan, your pension is based on the contributions and investment income that have accumulated in the plan by the time you retire. It will also depend on the type of retirement income plan you choose at that time. Under the tax rules, you and/or your employer may contribute 18 percent of your earnings (up to a maximum of \$19,000 in 2006).

Not all private pensions are protected from inflation

Some plans provide full or partial indexation of benefits. Other plans provide discretionary increases from time to time. Most private plans do not provide indexing at all.

Pension income is taxable

Once you receive your pension, the income is taxable. This is because no tax was paid on the funds while you were contributing.

Planning to leave your company before you retire? What about your pension options?

You normally participate in an employer pension plan for certain number of years before you have a right to receive benefits from it. At that time, your benefits are said to be "vested"; your contributions are locked in and can only be used to provide retirement income. If you leave your employer before your benefits are vested, you are entitled to a refund of your contributions, plus interest. If you leave after your pension is vested, you normally have three options:

- take a pension when you reach retirement age;
- transfer your pension funds to another pension plan if your new employer agrees;
- or transfer your pension funds to a registered retirement account. This could be a "locked-in retirement account" or a "locked-in RRSP", depending on your original pension plan. At retirement, you will need to transfer your funds to a Life Income Fund or use the funds to purchase an annuity.

Rules about vesting, locking in and withdrawing funds vary, depending on the legislation that governs your plan.

Registered Retirement Savings Plans (RRSPs)

RRSPs are individual, personally managed savings plans. Like employer pensions, savings in an RRSP receive tax assistance - contributions are tax deductible and investment income is not taxed as it is earned. The tax is paid when funds are withdrawn from these plans. RRSP funds may be invested in a range of financial products and investment vehicles, including savings accounts, Canada Savings Bonds, term deposits, guaranteed investment

certificates, and mutual or segregated funds. You can set up an RRSP through most financial institutions - banks, credit unions, trust companies, mutual fund companies, insurance companies, and investment dealers or brokerage firms.

Your annual deduction limit

You're allowed to contribute as much as 18 percent of your previous year's earned income to an RRSP, up to a maximum dollar amount of \$18,000 as of 2006. If you're a member of an employer pension plan, your RRSP limit is reduced by a "pension adjustment" to account for your annual pension savings. Canada Revenue Agency informs you of your deduction limit through your annual Notice of Assessment or Notice of Reassessment. If you do not contribute the maximum amount to your RRSP in a year, you may carry forward the unused deduction limit and use it in a future year.

How much income to expect

The amount of income you can expect from your RRSP depends on the contributions and investment income that have accumulated in the plan by the time you retire. Basically, it depends on how much you save, the length of time your contributions have to grow and how well your investments do.

You must pay tax on amounts withdrawn from an RRSP

The objective of RRSPs is to provide retirement income. However, any time you withdraw funds from your RRSP, the amount is taxable. Your RRSP issuer withholds the necessary tax.

Converting your RRSP when you retire

You may contribute to an RRSP up until the end of the year in which you turn 69. By the end of that year, you must convert your RRSP to a RRIF, purchase an annuity or withdraw the funds in a lump sum. In an RRIF, you must withdraw a minimum amount each year. You will be required to pay tax on this income. Your RRSP or RRIF withdrawals add to your income and could affect the amount of your OAS benefits.

Other Personal Savings and Investments

There are many other non tax sheltered ways you can set aside money for retirement. Make sure that you understand the tax treatment of each type of investments you hold, as it can vary.

What to do next

Figure out the retirement income you'll receive from your private pensions and savings. There are basically three steps to take to find out how much retirement income your pensions and savings will provide: 1) Consider how much you have saved so far; 2) Project how much you will save between now and when you expect to retire, including the investment growth; 3) Estimate the annual pension income that your savings will generate.